United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

75-7538

ORIGINAL

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P/S

In The

United States Court of Appeals

For The Second Circuit

ALAN L. SPIELMAN,

Plaintiff-Appellant,

vs.

GENERAL HOST CORPORATION, RICHARD C. PISTELL, HARRIS J. ASHTON, C. WHITCOMB ALDEN, JR., JOSEPH P. BINNS, WILLIAM F. DOWNEY, WESTON E. HAMILTON, WILLIAM P. HOWE, JR., J. ELROY McCAW, EDWIN C. McDONALD, LESLIE W. SCOTT, ALLEN & COMPANY, INCORPORATED, ALLEN & COMPANY, KLEINER, BELL & COMPANY, INCORPORATED, SEYMOUR M. LAZAR, EUGENE V. KLEIN, ALLEN MANUS, CECIL MANUS, and GREAT AMERICAN INSURANCE COMPANY,

Defendants,

GENERAL HOST CORPORATION, RICHARD C. PISTELL, HARRIS J. ASHTON, C. WHITCOMB ALDEN, JR., JOSEPH P. BINNS, WESTON E. HAMILTON, LESLIE W. SCOTT, ALLEN & COMPANY, INCORPORATED, and ALLEN & COMPANY,

Defendants-Appellees.

Appeal From a Judgment of the United States District Court for the Southern District of New York

REPLY BRIEF FOR PLAINTIFF-APPELLANT

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POINT I

DEFENDANT' CONFLICTING CONTENTIONS EXPOSE THE INADEQUACY OF THE PROSPECTUS DISCLOSURES

Defendants strenuously argue that the total mix of communications fully apprised the Armour shareholders of all material facts and of the alleged omissions in the prospectus (Defendants Brief p.35). The falsity of this contention is best evidenced by defendants' admission on page 7 of their brief wherein they stated:

> "The competing Greyhound offer, and continuous criticism by Armour in various legal forums and in the press on Host's ability to finance an impasse in the event it was not able to assume immediate operating control, resulted, after discussions with the SEC, in the addition of language to the prospectus prior to the effective date (JA 465-66). In this added language, Armour's shareholders were warned..." [emphasis added]

Host, thus, recognized that even in view of the Armour criticisms it was obligated in the prospectus to warn Armour shareholders concerning the obstacles to its gaining "operating control" and the difficulties it might encounter in servicing the debentures. This admission renders meaningless defendants argument that the communications of the Armour management cured the discloure deficiencies of the prospectus.

It is respectfully submitted that the language added to the final prospectus not only failed to warn of the material problems that lay ahead but instead gave false assurances that Host was not exposing itself to any future significant risks. Indeed, the prospectus contained no warning of what defendants now admit were "...obstacles to Host gaining operating control of Armour..." (Defendants Brief p.23), but instead represented that (1) "General Host may find it desirable to dispose of portions of the assets presently held by it or by Armour." and (2) "General Host may find it necessary or desirable to increase the dividend paid on common stock by Armour..." These two important representations were materially misleading, in that they led the Armour shareholders to believe that Host would gain operating control over Armour as a result of the Exchange Offer. They also gave false assurance to the Armour shareholders as to Host's ability to meet its debt obligations from those sources if it so chose.

Not only do defendants recognize that warnings were required and that the added prospectus language was material, but also that obstacles to operating control existed.

> "There were obstacles to Host's gaining operating control of Armour, and there was the possibility that approximately two years could elapse after the offer before such control would be obtained." (Defendants' Brief, p.23).

Yet in view of that recognition, the prospectus contained no discussion of the "obstacles". Defendants argue that a

bare reference to the staggered board and cumulative voting provisions in the prospectus Appendix, without benefit of cross reference or explanation, gave the warning which they deemed necessary. This argument stands in stark contrast to defendants' further contentions that "the degree of emphasis given to the staggered board and cumulative voting in the prospectus accurately reflected the significance these points had to persons connected with the offer on both sides." (Defendants Brief p.24). Having previously recognized the materiality of the "obstacles", the implication of the above statement is that the issue was of minor significance.

The difficulty in defendants' argument is best evidenced by their own attempts to stretch the prospectus language. In their brief, at page 18 defendants state:

> "Host indicated, as the first possibility, that it might find it desirable to propose to stockholders a merger or consolidation, or a disposition of assets held by it or by Armour." (Emphasis supplied)

Thus, defendants now read the prospectus as having disclosed that consent of stockholders was required in order to dispose of Armour assets. In fact, the prospectus merely states that "...General Host may find it desirable to dispose of portions of the assets presently held by it or by Armour." It gives no inkling that such acts would require anything but Host's approval.

As another recourse, the prospectus stated, at page 9, that Host "might find it necessary or desirable to take other steps, the first of which is to increase the dividends paid on Armour stock." Defendants submit that:

> "While a dividend increase would require affirmative Armour board action, there is no suggestion in this sentence of when or whether such a dividend increase would take place" (Defendants' Brief pp. 18 and 19).

The prospectus did not explain that affirmative Armour board action would be required to increase the dividend and, contrary to defendants' present assertions, plainly implied that Host would have the immediate ability to obtain funds from Armour through the mechanism of increasing Armour dividends. The question for the Armour shareholders at the time of the exchange offer was not "when or whether such a dividend increase would take place" but rather, whether it could occur if required. The prospectus falsely assured them that it could.

On the facts above demonstrated, review of defendants' attempts to distinguish Mills v. Electric Autolite Co., 403 F.2d 429 (7th Cir. 1968), vacated on other

grounds, 396 U.S. 375 (1970) shows the complete bankruptcy of defendants' case:

Defendants' Statement	Fact
"(a) the Mills proxy statement contained a misrepresentation as to the board's disinterested advice, while the Host prospectus included no misrepresentation;*	Host represented that it could raise funds through certain actions, a statement which was misleading in the absence of disclosure of the obstacles to control.
(b) the issue of disinterestedness in Mills was known to be a crucially significant fact, whereas the impediments to immediate control received reasonable emphasis in the prospectus in view of their less than crucial importance;	The issue of control was the single most important issue in determining whether or not the Host debentures had value comparable to the Greyhound cash offer.
(c) the minority stockholders of Autolite were not placed on their guard but instead were left helplessly unaware, while Armour stockholders were clearly appraised of the possible legal impediments (i e. the staggered board and cumulative voting) to Host's obtaining operating control in the most logical location for such information; and	Nowhwere in the Host prospectus was there any statement warning the Armour shareholders that Host might not be able to gain control of Armour; instead, the Prospectus was filled with statements implying that control was imminent.
(d) the controlled Autolite directors would not correct the misleading representation conveyed by the Autolite proxy statement, while Armour's shareholders had Armour's management scrutinizing with hostile eyes the accuracy of everything Host said." (Defendants' Brief page 25)	The Armour management never suggested in its communications that Host might not be able to control Armour if it acquired a majority of the Armour share; nor did Armour raise this issue in its injunctive action.

* On the contrary, the proxy statement in the Mills case was held misleading because of its failure to state the interlocking nature of the boards within the context of the board's advice.

II

DEFENDANTS HAVE MISCONCEIVED THE EXTENT OF THE CONTROL PROBLEM

In its opinion, the Trial Court addressed the obstacles faced by Host in obtaining control of Armour solely in terms of Host's ability to obtain immediate control of Armour, disregarding the possibility (and, indeed, the eventuality) that Host would never gain control of Armour. Defendants seek to convince this Court that once Host acquired more than 50% of Armour's shares through its exchange offer (the "Exchange Offer") operating control was inevitable, stating:

> "Once it [Host] obtained a majority of Armour's voting stock, it was inevitable that Host would take control of Armour's board (JA 414-425). At most this required that Host vote its shares at three annual meetings to elect a majority of each of three classes of directors into which Armour's board was divided (JA 415)" (at page 9).

Defendants, however, admitted that ownership of a control block of shares and working control are not the same (JA 414). As it turned out, prior to the sale to Greyhound, Host never controlled Armour, and its questionable ability to obtain control was a reason cited by Allen Inc. for recommending that Host abandon its quest for control of Armour (JA 903-8).

III

CUMMUNICATIONS FROM ARMOUR DID NOT AND COULD NOT CURE THE DEFECTS IN THE PROSPECTUS

Defendants' contention that the Armour communications cured the defects in the prospectus is also without merit. Nowhere in its communications did Armour even warn of the possibility that Host might be unable to gain control of the Armour board if it acquired more than 50% of the Armour stock, much less discuss the significance of the obstacles in Host's way. The Armour communications failed to raise the question of control, just as Armour had failed to raise this question in its injunctive action. The bare disclosures of the staggered board and cumulative voting provisions in a context unrelated to the Host offer could not have reasonably apprised the Armour shareholders of the dangers inherent in the Host offer. Bombarded from both sides, the Armour shareholders could reasonably be expected to rely on the formal prospectus, which defendants for other purposes argue bore the imprimatur of the SEC. Cf. Electronic Specialty Co. v. International Controls Corp., 409 F. 2d 937, 948, n.7 (2d Cir. 1969).*

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*(See also Point I infra for other effects upon Armour shareholders arising from prior communications).

IV

DEFENDANTS CANNOT RELY UPON THE SEC'S EFFECTIVENESS ORDER

The Trial Court at the urging of defendants' counsel found it appropriate to accord "some weight" to the SEC's order declaring the Prospectus effective (JA 719). Such a conclusion was so obviously in error that plaintiff limited discussion of this ruling to a footnote in his brief on this appeal (footnote 22 on page 36). In their answering brief, defendants have not only again raised this argument but have embellished it (on pages 10 and 11), stating:

> "Normally, the Commission's staff would have passed on this prospectus. But it is understandable that in this case the Commission itself took the unusual step of passing on the prospectus (JA 659) because the Commission and its staff were inundated with letters and memoranda from Armour's law firms criticizing the Host exchange offer."
>
> "The Commission itself accelerated the effective date of Host's registration statement. Thus both the SEC staff and the full Commission reviewed the language of which plaintiff now complains (JA 482, 659, 719, 1415]Ex.A-51]."

In support of their contention, defendants cite the parties' stipulation No.38 (JA 659) which provides that "the Commission, not the staff, pursuant to delegated authority, declared the registration statement effective on January 30, 1969." This statement in no way indicates that any SEC

commissioner, much less a majority of the five commissioners, reviewed the prospectus. On March 8, 1963, the Commission delegated to the staff the authority to accelerate the effective date of registration statements of reporting public companies, which included that of Host.* Defendants further cite the Commission's order in support of their contentions. This order (Exhibit A-41, JA 1415), typed on "order form 2" - a standardized order used at the time, specifically referenced section 23 of the Securities Act of 1933 which provides as follows:

> "Neither the fact that the registration statement for a security has been filed or in effect, nor the fact that a stop order is not in effect with respect thereto shall be deemed a finding by the Commission that the registration statement is true and accurate on its face or that it does not contain an untrue statement of fact or omit to state a material fact or be held to mean that the Commission has in any way passed upon the merits of, or given approval to such security. It shall be unlawful to make or cause to make to any prospective purchaser any representation contrary to the foregoing provisions of this section."

Further underscoring the hollowness of the defendants' argument is the fact that the Commission subsequently brought an action against the defendants herein (73 Civ. 275 SDNY) alleging among other things, that the disclosures in the Prospectus relating to the Cash-Flow Problem were false and misleading.

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*Securities Act Release No. 4588.

Thus, there is no evidence indicating that the Commission gave any consideration to the adequacy of the Prospectus' disclosures prior to the effective date. Yet it is clear that when the Commission did consider the prospectus it found it wanting.

CONCLUSION

For the foregoing reasons, the judgment of the District Court should be reversed.

Respectfully submitted,

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A 202 Affidavit of Personal Service of Papers — LUTZ APPELLATE PRINTERS, INC.

~~UE~~, COURT OF APPEALS
FOR THE SECOND CIRCUIT

SPIELMAN,
~~Defendant~~- ~~Appellee~~
Plaintiff- Appellant,

- against -

GENERAL HOST,
Defendants- Appellees

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Affidavit of Personal Service

STATE OF NEW YORK, COUNTY OF **NEW YORK** *ss.:*

I, Victor Ortega, *being duly sworn, depose and say that deponent is not a party to the action, is over 18 years of age and resides at* 1027 Avenue St. John, Bronx, New York

That on the **13th** *day of* **Febrary** *19* **76** *at* **see attached**

deponent served the annexed **Reply Brief** *upon*

see attached

the **Attornyes** *in this action by delivering a true copy thereof to said individual personally. Deponent knew the person so served to be the person mentioned and described in said papers as the* *herein,*

Sworn to before me, this **13th** *day of* **Febrary** *19* **76**

Robert T. Brin

ROBERT T. BRIN
NOTARY PUBLIC, State of New York
No. 31-0418950
Qualified in New York County
Commission Expires March 30, 1977

Victor Ortega

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